

Economics questions: The Keynes question

<https://www.taxresearch.org.uk/Blog/2025/09/17/the-keynes-question/>

Published: January 12, 2026, 8:28 pm

This is one of a series of posts that will ask what the most pertinent question raised by a prominent influencer of political economy might have been, and what the relevance of that question might be today. There is a list of all posts in the series at the end of each entry. The [origin of this series is noted here](#).

After the first two posts in this series, the topics have been chosen by me, and this is the first of those. This series has been produced using what I describe as directed AI searches to establish positions with which I agree, followed by final editing before publication.

The Keynes Question

[John Maynard Keynes](#) remains, in my opinion, the most important economist of the twentieth century. His 'General Theory of Employment, Interest and Money', published in 1936, was written in the depths of the Great Depression. Its central message was revolutionary in economic terms: Keynes suggested that markets are not self-correcting, that demand can fail for prolonged periods, and that when that happens the state must intervene as a spender of last resort.

Keynes overturned the economic orthodoxy. Until he wrote, the consensus had been that supply creates its own demand, as [Say's Law](#) suggested. If workers were unemployed, it was assumed their wages were too high or they were insufficiently flexible. Keynes challenged this logic. He showed that when demand collapses, unemployment can persist indefinitely, even if workers are willing to work for less. Without state intervention, there is no automatic recovery.

And yet, almost a century later, governments repeatedly ignore him. That then leads to the **Keynes Question: if the economics of public intervention in a slump is so clear, why do governments so often refuse to spend when they are most**

needed?

1. The paradox of thrift

Keynes based his explanation of recession on what he called the paradox of thrift. If one household tightens its belt, that may be prudent. But, he said, if all households cut spending at once, total demand falls, incomes shrink, and the ability to save collapses. What is rational for one household in isolation becomes ruinous if it is done by all, simultaneously.

This paradox applies to governments, too. When recessions strike, tax revenues fall and welfare payments rise. Cutting spending in response simply deepens the downturn. In that situation, only the government can expand demand to offset private retrenchment.

2. Multipliers that matter

Keynes also identified the multiplier effect. Government spending does not simply add one-for-one to GDP. It triggers further rounds of spending as wages are paid, suppliers are contracted, and consumption rises. In a depressed economy, the multiplier is large. A pound of public spending can generate far more than a pound in economic output.

That means state spending is not only necessary to fill the demand gap; it is also highly effective. Stimulus works best when the economy is weakest.

3. Hysteresis: the cost of delay

Keynes stressed that unemployment is not just a temporary inconvenience. It inflicts long-term scars. Workers who are unemployed lose skills. Young people who cannot find work suffer permanently lower lifetime incomes. Business delays or cancelled investments leave the economy weaker in the future.

This is what economists now call hysteresis: temporary slumps can permanently reduce potential output. In other words, refusing to spend now means condemning future generations to lower prosperity.

4. The politics of refusal

Despite the clarity of the Keynesian case, governments time and again retreat to austerity. After the financial crash of 2008, the UK government under George Osborne slashed spending at the very moment it was most needed. The result was the slowest recovery in modern history and a decade of wasted potential.

Why do they do it? Keynes himself suggested one reason: austerity appeals to a false sense of morality. Politicians and media insist that “belt-tightening” is virtuous, while borrowing is sinful. The household analogy — governments must live within their means, just like families — has immense political force, even though it is false.

But the deeper reason is structural. Austerity disciplines labour. By maintaining a pool of unemployed or insecure workers, wages are held down and labour’s bargaining power is weakened. At the same time, austerity shrinks the state, leaving more space for private capital. Austerity may be bad economics, but it is useful politics for elites.

5. Keynes’s unfinished revolution

Keynes gave us the tools, but his revolution was never fully secured. The post-war Keynesian consensus did create decades of full employment and social progress. But from the 1970s onwards, neoliberal economists attacked Keynesianism and neo-Keynesianism (and they are not the same thing) as dangerous, inflationary, and irresponsible. They restored the myths of balanced budgets and self-correcting markets.

Today, even self-described progressive politicians talk of “fiscal responsibility” and “living within our means.” The Keynesian lesson — that the state must spend when demand collapses — has been buried under neoliberal dogma.

6. What answering Keynes would mean today

To take Keynes seriously today would require:

Rejecting arbitrary fiscal rules. Stop binding governments to debt and deficit ratios that ignore real needs.

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Embedding automatic stabilisers. Ensure that public investment, welfare spending, and local government funding expand automatically when unemployment rises.

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Targeting real resources, not financial myths. The true constraint is the availability of labour, skills, and ecological capacity, not an accounting balance.

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Investing in the future. Spend on green transition, care, housing, and education to prevent hysteresis and build resilience.

Inference

The Keynes Question remains hauntingly relevant: if the state must act as spender of last resort, why do governments refuse to spend when private demand fails? The economics is clear. The refusal is political. It reflects ideology, vested interests, and the enduring power of myths about money.

Keynes showed us how to escape slumps. The real puzzle is why we still choose not to follow him. Until economics confronts that refusal, recessions will keep scarring lives, and austerity will keep eroding society in the name of lies.

Previous posts in this series

* [The economic questions](#)

* [Economic questions: The Henry Ford Question](#)

* [Economic questions: The Mark Carney Question](#)

Taking further action

If you want to write a letter to your MP on the issues raised in this blog post, there is a ChatGPT prompt to assist you in doing so, with full instructions, [here](#).

One word of warning, though: please ensure you have the correct MP.

ChatGPT can get it wrong.

Comments

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